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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1941.

No. 283

BUTLER BROTHERS, A CORPORATION,
Appellant,

vs.

CHARLES J. McCOLGAN, AS FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA.

BRIEF OF APPELLANT IN OPPOSITION TO APPELLEE'S MOTION TO DISMISS OR AFFIRM.

LELAND K. NEEVES,
JAMES S. MOORE, JR.,
Attorneys for Appellant.

THE DONNELLEY-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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MAY IT PLEASE THE COURT:

Pursuant to the provisions of Rule 12, paragraph 3, Appellee herein has filed a motion to dismiss or affirm. Appellant files this brief in opposition to such motion as provided in Rule 7, paragraph 3.

The asserted ground for Appellee's motion is that there is no substantial Federal question presented for the reason that "the questions presented have been so thoroughly foreclosed by previous decisions of this court as to leave no debatable ground" for attacking the decision of the court below.

The facts stipulated to by the parties to this suit are set out at some length in Appellant's Jurisdictional Statement heretofore filed (p. 11 *et seq.*), and we ask the Court to consider the facts as there stated, or, if need be, the stipulation of facts as it appears in the record, rather than the facts as stated in Appellee's present motion.

Appellee's motion seems to be premised upon the theory that the facts stipulated by the parties and adopted by the trial court as its findings of fact do not show or tend to show that Appellant's operations in California resulted in a loss in fact. Premised upon such erroneous theory Appellee contends that the instant case does not come within the principles announced in *Hans Rees' Sons, Incorporated* v. *North Carolina*, 283 U. S. 123. Appellee further contends in effect that the *Rees* case has been overruled by *North American Cement Corporation* v. *Graves*, 299 U. S. 517, which latter case follows and is based upon the *Bass* and *Underwood* cases.

The judgment of the court below upholds the validity of an apportionment method of taxation and the consequent validity of the statute pursuant to which such apportionment method is applied—thereby establishing for tax purposes a "net income" in California although the facts, as stipulated, show that Appellant had no "net income" in California, but rather a loss. As pointed out in our Jurisdictional Statement a loss in *fact* of $82,851 has been converted by use of the apportionment method into a "net income" of $93,551.50. It would seem obvious that under the holding in the *Rees* case an apportionment method of taxation, albeit fair on its face, and a taxing statute, also fair on its face, may not be applied so as to result in any such unreasonable and arbitrary manner. No such apportionment method and no such statute will be permitted to create taxable income where none exists in fact.

On page 7 of its motion and argument Appellee makes the statement that there has been no explanation as to

"why Appellant's method of operation should produce a loss in California while it was producing a large income from its total operations." The court below in its opinion (Jurisdictional Statement, p. 55) says:

> "In the case at bar Appellant has not furnished any explanation of why its California business differs so from the average that the formula produced an erroneous result. Here there has been only an assertion that a loss occurred in this State."

Such statements are naive to say the least. It is the same as saying that every branch or division of a company's business must be profitable. However, as in the instant case, it is not a question as to why Appellant's San Francisco House was unable to operate at a profit. The only material fact is that according to the record facts it did operate at a loss. Notwithstanding the court's statement above quoted that in the instant case there has been only an "assertion" that a loss occurred in California we nevertheless read the opinion of the California Supreme Court as not seriously questioning but that the facts as stipulated show, or tend to show, that a loss resulted in California and as not turning upon any factual question as to whether such a loss resulted. However, in view of the court's statement we take the time to refer to the record facts. Appellant's income from the operation of its San Francisco House was computed

> "by deducting from the gross receipts from sales of merchandise in California, determined as indicated in paragraph 2 of the stipulation, the costs of such merchandise, determined as indicated in paragraph 3, the direct expenses of the San Francisco house referred to in paragraph 3, and the indirect expense allocated to the San Francisco house in the manner described in paragraph 4. According to this computation, the San Francisco house operated at a loss of $82,851 during the year 1935." (Jurisdictional Statement, p. 13; Stipulation of Facts, Par. 5.)

The gross receipts in question are the amounts paid by the customers for the goods sold from the San Francisco house out of stocks maintained there—all receipts from sales made in California being credited to the San Francisco house. (Jurisdictional Statement, p. 12; Stipulation of Facts, Par. 2.)

The cost of the merchandise is the actual cost thereof plus transportation charges — the merchandise being shipped directly by the manufacturers to the San Francisco house, and no charge being made against such house for the benefit of the company or any other house by reason of the centralized purchasing. (Jurisdictional Statement, p. 12; Stipulation of Facts, par. 3.) The direct expenses of the San Francisco house are those which are directly and exclusively incurred at such house, including such items as labor, rentals, and similar expenses. (Jurisdictional Statement, p. 12; Stipulation of Facts, par. 3.) The indirect expenses which are allocated in part to the San Francisco house are:

> "Certain items of expense which are incurred and paid by the Company for the benefit of all the houses, the costs of which are allocated to the respective houses. * * * For the year 1935 the amount of such allocated expense charged to the San Francisco house was $100,091, of which 75 per cent would have been incurred by appellant even though the San Francisco house was not operated." (Jurisdictional Statement, p. 13; Stipulation of Facts, par. 4.)

It also appears in said paragraph 4 of the Stipulation that no question exists as to the accuracy of the amounts of such common expense or to the method of allocation employed which is in accordance with recognized accounting practices; that the accuracy and propriety of the basis of allocation of such common expenses for the year 1935 are admitted and that included in such expenses

> "are executive salaries, certain accounting expenses, the cost of operating a central buying division and a

central advertising division." (Jurisdictional Statement, p. 13; Stipulation of Facts, par. 4.)

Said paragraph 4 further states that except for such common expenses each house is operated independently of each other house. (Jurisdictional Statement, p. 13.)

Under such a Stipulation of Facts Appellant's loss in California is established, not by mere assertion, but by actuality—by the "evidence" which this Court in the *Rees* case said had been produced there but which it said was lacking in the *Underwood* and *Bass* cases.

That an apportionment formula, however it is set up, is an approximation only, and will yield to a more accurate determination of income is established by all the cases decided by this Court where the question of the validity of an apportionment method is involved. And this is true even in *Norfolk & Western Ry. Co.* v. *North Carolina*, 297 U. S. 682, one of the cases strongly relied upon by the court below. That case involved an apportionment of income based upon mileage within the state compared with the total mileage of the company. While such apportionment method was there sustained for the reason that the evidence was not sufficient to show that such method did not result unreasonably or arbitrarily, this Court clearly recognized that if income within the taxing state was susceptible of determination by some method other than by an apportionment method such other method should be followed. In that connection this Court said, 297 U. S. at page 685:

> "Taxpayer and state would be swamped with administrative difficulties if left to struggle through every case without the aid of a formula of ready application. In the perplexities besetting the process of assessment the statute is the outcome of a reasonable endeavor to arrive at a proportion of general validity. • • •
>
> "• • • A segment of the line may operate under handicaps resulting from the nature of the traffic, the topography of the country, the maladjustments or inadequacy of passenger or freight tariffs in one dis-

trict or another. As applied to such a segment the average mileage prorate of the entire railway system may be an arbitrary test of the relation between revenue and expenses. * * * If this is made to appear with an ensuing burden on the taxpayer grossly in excess of the results of a more accurate apportionment, the statute to that extent is an unconstitutional endeavor to tax the income of a business in another jurisdiction. *Hans Rees' Sons* v. *North Carolina, supra.*"

We have said above that we do not read the opinion of the court below as turning upon any factual question as to whether a loss did or did not result in California. We think this view of the opinion is amply supported by the statement of the court below as to the question presented for determination (Jurisdictional Statement, p. 44):

"The sole question to be determined on this appeal is whether it is lawful and proper for the respondent, as Franchise Tax Commissioner, to insist upon use of the formula for allocation of income in a case such as this, or whether the company is entitled to use the separate accounting of its San Francisco house to determine its net income in the State of California. *The answer to this question depends entirely on the nature of the business conducted within and without the State by appellant, a foreign corporation.* It is only if its business within this State is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used. Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer." (Citing cases.)

And further:

"If there is any evidence to sustain a finding that the operations of appellant in California during the year 1935 contributed to the net income derived from

its entire operations in the United States, then the entire business of appellant is so clearly unitary as to *require* a fair system of apportionment by the formula method in order to prevent overtaxation to the corporation or undertaxation by the state." (Italics ours.)

The court then, as we have pointed out, held Appellant's business to be "unitary" and therefore concluded (contrary to the *Rees* case) that an apportionment method became mandatory. It is inconceivable how the California Supreme Court could have so held in the face of the *Rees* case that the fact that the business is "unitary" is not the controlling factor. And when we see that, as in the instant case, the business is not even a "unitary" one in the concept of that term expressed in the *Rees* case, the case is even a more flagrant one of the taxation of property or income or business not within the taxing power of the State of California. In the instant case the ultimate gain of Butler Brothers is not derived from the entire business. Its gain is an aggregate of the gain or loss of each of its branch Houses. And where a loss has resulted in a given branch House as in California the basis for the application of an apportionment method does not exist.

The California court's statement quoted above is also completely negatived by the *Norfolk & Western* case which it itself cites and relies upon. We can hardly conceive of any division of the business which is less "separate and distinct" from the company's out-of-the-state business than the railway mileage of the Norfolk & Western in North Carolina. And yet this court recognized that even in the case of such a rail carrier a statutory formula must yield to the requisite factual showing as to the "income" of the lines within the state.

In the light of Appellant's method of doing business and the separateness of the operations of its various houses including the San Francisco house, we can think of no more

accurate method for determining the results of the operations of any of the houses, including those of the San Francisco house, than the method followed by Appellant in the instant case—a method not devised merely for tax purposes but devised and used in the actual conduct of its business affairs. That this latter statement is true appears from the Stipulation of Facts with reference to the keeping of separate accounts at each house and as to the items entered therein. See Stipulation of Facts, paragaphs 2, 3 and 4; Jurisdictional Statement, pp. 12-13.

Whether such method for the determination of the income at Appellant's various houses be deemed "separate accounting" or otherwise, the essential fact is that such method is an accurate method, and lends itself with reasonable certainty to a determination of the actual results of the operations of the several houses. Such being the case, there is no room for the application of an apportionment method.

On page 7 of its motion and argument Appellee attempts to distinguish the *Rees* case with the statement that the evidence there tended to show that the manufacturing was only slightly responsible for the company's profits, whereas the formula had the effect of attributing nearly the entire profit to the state of manufacture. It is stated in the opinion of this Court in the *Rees* case, 283 U. S. at page 128, that there was allocated to North Carolina the following percentages of the company's total income; 83 per cent for 1923; 85 per cent for 1924; 66 per cent for 1925; and 85 per cent for 1926. The evidence offered by the company which was excluded by the trial court tended to show that about 17 per cent of the company's income was attributable to the manufacturing operations in North Carolina. (See also page 134 of the opinion.)

In the instant case it is true that the apportionment method allocated to California some 8 per cent of Appel-

lant's total income. (Jur. St., p. 13.) And it is upon this fact that Appellee argues that the income allocated to California under the apportionment method here applied did not allocate to California an unreasonable portion of Appellant's total income. But that, we submit, is not the controlling factor. As stated, the apportionment method here applied has resulted in converting an actual loss of $82,000 into a net profit of $93,000. The apportionment method has simply created out of nothing additional income in California of some $175,000. The question for decision is whether or not an apportionment method and the statute itself authorizing such method can be applied so as to bring about such a result. As shown by the *Rees* case, an apportionment method will and must yield to a more accurate method of determining income.

On page 6 of Appellee's motion and argument he says that this Court has held that the formula method of allocation cannot be accepted in part and attacked in part. Reference is made to *Norfolk & Western Ry. Co.* v. *Maxwell*, 297 U. S. 682. Appellee's contention in this respect differs somewhat from the contention of the California Supreme Court also based upon the *Norfolk & Western* case. The court below said (Jurisdictional Statement, p. 55):

> "As appellant has failed to show a variance from normal in either the California sales, property or payroll, or in either expenses or revenue, it is our conclusion that appellant has not upheld its burden of proof, for in order to overthrow a formula the taxpayer must introduce such evidence and the evidence must go to each element of the formula equation."

What Appellee means by his statement is that there were certain expenses in the way of general overhead and the like which necessarily had to be divided up or allocated among the various branches or divisions of Appellant's business, which expenses were allocated upon a percentage

basis. If Appellee's contention in this regard were correct it would never be possible to determine a separate income in any one state in the case of a corporation doing business in various states under a single management or control inas much as there must always be in such cases some sort of an allocation of the common expense among the various states.

In view of Appellee's contention and of the court's statement, we take time to state what we understand the holding in the *Norfolk & Western* case to have been. In that case taxable net income of interstate railways was based upon the proportion of mileage within the state to the railroad's total mileage. Under the apportionment formula the "gross revenues" were first determined by the mileage ratio and the gross expenses, also determined by the mileage ratio, were then deducted. The railroad in question accepted the gross revenues determined upon such mileage ratio but claimed that the gross expenses determined by such ratio were substantially less than the expenses of the North Carolina mileage. As to whether the expenses of the North Carolina mileage were more or less than those as determined by the statutory formula this Court said (297 U. S. at page 686) that there was evidence in the record giving support to the company's position and that up to that point the company took upon itself the burden of making out a case for the rejection of the formula. This Court then said, however (p. 686):

> "There, however, it stopped, declining to go further. From the testimony of its witnesses we learn that actual expenses were greater in North Carolina than the average expenses apportioned to that state on the basis of the ratio between state and system mileage. We learn nothing from the witnesses as to the ratio between revenues, average and actual. For all that appears in the case developed by the Railway actual gross revenues in North Carolina may have been so far in excess of average gross revenues com-

puted under the statute as to neutralize the discrepancy between actual and average costs of operation. If such a counterbalance exists, appellant has not been injured through the application of the formula."

It then appeared that the state itself had offered evidence that through the application of the formula the gross revenues of the North Carolina mileage were underestimated to a greater extent than the operating expenses. On this branch of the case the company's witnesses claimed that there was no method of allocating revenues with any greater approach to certainty than by means of the mileage ratio. As to that testimony this Court said that either for that reason or some other the witnesses had not made an attempt to ascertain receipts, no matter how approximately, by any other method as assuredly they would have tried to do if the statutory formula had been abolished altogether. The trial court found that from the evidence the actual gross operating revenues if determined otherwise than by the formula "would be increased by a much greater proportion than the operating expenses in North Carolina are increased over the operating expenses determined by the use of the statutory formula." That finding was approved by the Carolina Supreme Court. This Court then went on to say that the taxpayer attacking the formula could not attack the prorating on the expense side and offer no evidence as to the revenue side, and that the evidence

> "to be effective must be directed to each of them alike, for only thus can the assumed relation between them be proved to be unreal. This taxpayer disclaims the duty and even the endeavor to respond to such a test, It varies the numerator of the fraction while accepting the denominator."

Had Appellant in this case applied an allocation formula to its total expenses at all houses, and at the same time insisted upon using as the gross revenue of the San Francisco house only the actual receipts from sales made at

that house, or conversely if it had applied an allocation formula to its total sales or gross receipts and then used the actual expenses of the San Francisco house in determining its California income, a question would have been presented quite different from that presented by the present record. In the instant case both gross revenue and expense have been determined by the actualities of the operations of the San Francisco house, excepting only to the extent of the necessity of allocating to the San Francisco house as additional expense a reasonable proportion of the common expenses. While perhaps such common expenses could have been allocated upon some basis other than that actually employed, nevertheless there is no issue between the parties in that regard in view of the stipulation:

> "That the accuracy and propriety of the basis of allocation of such common expenses for the year 1935 are admitted." (Jurisdictional Statement, p. 13; Stipulation of Facts, par. 4.)

It is further to be noted that a simple arithmetical computation discloses that in view of the total sales of the San Francisco house amounting to $5,206,000 (Jurisdictional Statement, p. 14) and the operating loss of $82,851, the total operating costs must have amounted to $5,288,851, of which the allocated common expense amounted only to $100,091—less than 2 per cent of the total operating expense of the San Francisco house.

It was also stipulated that of the allocated common expense amounting to $100,091, 75 per cent would have been incurred even had the San Francisco house not been operated. (Jurisdictional Statement, p. 13.) Were this 75 per cent, or $75,000, eliminated from the San Francisco account entirely Appellant would still have incurred a loss at that house. Only by eliminating all of the allocated common expense would a "net income" result—and then only in the amount of $18,000, the difference between the $82,851 of loss as shown and the amount of the allocated common

expense of $100,091. However, as we see it, to eliminate from the San Francisco accounts any part of the overhead or other common expense would be not only to distort the income of that house, but also to distort the income of the other houses inasmuch as the other houses would have to absorb the whole of such expense.

Under the facts of this case the *Norfolk & Western* case does not support Appellee's position, or the decision of the court below. Certainly what this Court had to say in that case about a partial use of a statutory apportionment method in determining the income to be taxed by the taxing state has no relevancy to the instant case.

We also call this Court's attention to the fact that the court below, whether inadvertently or not, misstates the rule of even the *Underwood* and *Bass* cases, for in its opinion (Jurisdictional Statement, p. 48) it says that the only limitation on the use of a formula in the allocation or apportionment of the income of a unitary business is that the "formula must not be intrinsically arbitrary *and* it must not produce an unreasonable result." (Italics ours.)

The court thus states the limitation conjunctively instead of disjunctively as the decisions of this Court hold. It is not necessary that there be *both* an intrinsically arbitrary formula and an unreasonable result for the formula itself need not be inherently arbitrary if its application does not produce an unreasonable result. This is clear from the quotation from the opinion of this Court in the *Underwood* case immediately preceding the statement of the court below to which we have just referred. (Jurisdictional Statement, p. 48.)

Appellant's total income for 1935 amounted to but $1,149,000. It is to this income that the Appellee's percentage allocation was applied. But in the determination of that income there was taken into consideration the $82,000 loss in California. The result is that the remaining

houses produced an income of $1,231,000, and it is upon that income that the other states are entitled to impose taxes. And in producing that income the other houses received credit for their share of the Appellant's aggregate buying power by having their goods charged to them at the actual cost paid therefor plus transportation—just as in the case of the San Francisco house. The California Supreme Court recognizes the right of the other states to include as part of the income which they may tax that portion accruing from the favorable purchases to which they as well as California have contributed. If, however, California by a process of apportionment is given a taxable income of $93,000 the result is necessarily an addition to the Company's total income of $175,000—making such income $1,324,000 instead of the $1,149,000. In other words, by the action of the California Supreme Court Appellant's total net income is arbitrarily increased to the extent of $175,000 of income which is nonexistent in fact. Viewed in this light Appellant would not only be subjected to a double tax upon the same income but even more clearly California is enabled to tax income which properly and legally belongs in some other state.

On page 8 of its motion and argument Appellee suggests that in the case of a *franchise* tax the tax may be measured by a percentage allocation of the taxpayer's total income without regard to the factual situation. The argument is necessarily, therefore, that the decision in the *Rees* case does not apply in the case of a *franchise* tax as distinguished from an income tax.

In *Underwood Typewriter Co.* v. *Chamberlain*, 94 Conn. 47, 108 Atl. 154, the statute in terms imposed a tax upon the net income of the corporation to be apportioned to the state upon the designated basis of allocation. The state contended that the tax was in the nature of an excise tax. Others contended that the tax was a property tax, and still others contended that the tax was an income tax. The

Connecticut court held that the tax was an excise tax levied upon the privilege of doing business in the state—even though the tax itself was measured by a percentage of the corporation's total net income. In the same case in this Court, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, in considering the objection that the tax was imposed upon income arising from business conducted beyond the boundaries of the State of Connecticut, this Court said:

> "In considering this objection we may lay on one side the question whether this is an excise tax purporting to be measured by the income accruing from business within the state or a direct tax upon that income; for the 'argument upon analysis resolves itself into a mere question of definitions and has no legitimate bearing upon any question raised under the Federal Constitution.'" (254 U. S., p. 120.)

The New York statute involved in the *Bass* case and *North American Cement* case is clearly an excise tax. Neither of those cases was decided upon any distinction between an excise tax and an income tax. The North Carolina statute involved in the *Rees* case was in terms a tax upon net income, although it applied to a foreign corporation "doing business" within the state. See *Maxwell* v. *Hans Rees' Sons, Incorporated*, 199 No. Car. 42, at p. 47. The North Carolina court, in upholding the validity of the tax there involved, said that the method of measuring the tax (the apportionment method) on "net income" had been approved by this Court in the *Underwood* case, and that the Connecticut statute construed in that case was substantially identical with theirs. Apparently, therefore, the North Carolina statute must be taken to be an excise or franchise tax and not an income tax.

The California statute involved in the instant case is in terms an excise or franchise tax measured by net income and has been so considered by the California Supreme

Court. *Matson Navigation Co.* v. *State Board*, 3 Cal. (2d) 1, 43 Pac. (2d) 805, affirmed, *Matson Navigation Co.* v. *State Board*, 297 U. S. 441; *Pacific Co.* v. *Johnson*, 212 Cal. 148, 298 Pac. 489, affirmed *Pacific Co.* v. *Johnson*, 285 U. S. 480. Before any distinction can be made, therefore, between an excise or franchise tax on the one hand and an income tax on the other, and before the *Rees* case can be distinguished on that ground, it must be shown that the *Rees* case was dealing with an income tax and not an excise or franchise tax, and that this Court intended in the *Rees* case to make such distinction. We submit, however, that in the *Rees* case this Court intended no distinction between an excise or franchise tax on the one hand and an income tax on the other, and that it was following in that regard what it had said in the *Underwood* case that the question must be decided without regard to any such distinction. We are frank to say, however, that if any such distinction is now to be made, and if the question raised in the instant case for decision is to be briefed or argued upon the basis that there is such a distinction then there is added reason for this Court's taking jurisdiction, and Appellee's motion and argument affirmatively shows that a very substantial question exists which should be decided.

The court below states in its opinion (Jurisdictional Statement, p. 54) that the "formula method of allocating or apportioning the income in the case of a unitary business was approved" by that court in the *Matson* case, and affirmed by this Court. We do not believe this statement of the court to be accurate. The *Matson* case involved two California corporations and the question there was as to whether the statutory formula should be applied to a base which included receipts from interstate and foreign commerce. The companies contended, first, that the statute should not be interpreted as including such receipts in the tax base, and, secondly, that if they were to be so included

the statute was void. The California court held that the tax base should include receipts from interstate and foreign commerce and its decision in that regard was affirmed by this court. There is no such question in the instant case. The Stipulation of Facts here shows that sales were made from the San Francisco house throughout the territory which was attributable to it. In other words, sales were made in states other than California. All of the receipts from such sales were included in the San Francisco gross receipts in determining the net income or loss in California. No claim has ever been made by Appellant that the receipts of the San Francisco house derived from sales in interstate commerce should be excluded. The difference between the *Matson* case and the present case is clearly recognized in the opinion of this Court in the *Matson* case in its discussion of the *Rees* case, 297 U. S. at pages 444-5. As this Court there said, the question in the *Rees* case "was as to the apportionment of income to the taxing state," and that the controversy in the *Matson* case concerned the amount "to be paid for the privilege of using in California corporate franchises granted by that state" to the companies, and that "no question of apportionment is here involved."

Finally in its motion and argument, at page 8, Appellee takes us to task for having pointed out in our Jurisdictional Statement that the California Supreme Court, in arriving at its conclusion, had indulged in certain inferences and presumptions contrary to paragraph 12 of the stipulation. (Jurisdictional Statement, p. 7.)

We refer, by way of illustration, to such statements in the opinion of the court below as the following:

> "If the omission of the California sales would have no effect on the purchasing power, the omission of sales in an equal amount wherever made would likewise have no effect on the company's ability to purchase at a saving. Thus, by proceeding in turn from state to state, it could be shown that *none of the sales in any of the states* should be credited with the in-

come resulting from the purchasing of goods in large quantities." (Italics ours.) (Jurisdictional Statement, p. 46.)

"The former [the central advertising division] enables appellant to spread its advertising cost over more stores and units and to secure its advertising at a lower cost per unit, thereby making possible advertising opportunities unavailable to a single store; as to the latter (central accounting and management department), the volume of business resulting from operation of the company's several stores permits better as well as more costly services of accounting and management to be available to each store, whereas if each were separately operated, services of such quality in all probability would be too expensive to be practicable." (Jurisdictional Statement, p. 47.)

"In the case at bar appellant has not furnished any explanation of why its California business differs so from the average that the formula produced an erroneous result." (Jurisdictional Statement, p. 55.)

All of these are matters wholly outside of the Stipulation of Facts, and amount to mere speculation and conjecture on the part of the court in direct violation of paragraph 12 of the Stipulation of Facts.

In the Petition for Rehearing which was filed in the California Supreme Court, and which is included in the record filed herein, we called the Court's attention to these conjectural matters. As to the first statement above quoted, perhaps the court merely meant that the elimination of sales at any house equal to those at the San Francisco house would not affect the company's aggregate buying power. But even this would be problematical. Suppose that some other of appellant's several houses, say the Chicago house, had total sales of $15,000,000. Then suppose further that $5,000,000 of these sales were eliminated. What the result would be if carried to a normal and logical conclusion is purely conjectural. If such an event were to take place, the Chicago house might not be able

even to operate, thereby eliminating—through cause and effect—the whole of the $15,000,000. So far as anything appearing in the stipulation in this case is concerned such elimination would most certainly affect the company's aggregate buying power. The statement of the California Supreme Court therefore in this light must be considered purely as an abstraction and meaningless.

As a matter of fact, however, we are inclined to doubt if the California court intended such a limited meaning to its statement. The following sentence is that by proceeding in turn from state to state it could be shown that "none of the sales" in any of the states should be credited with the income resulting from the purchasing of goods in large quantities. We would understand the court to mean by this statement that the elimination of the whole of the sales at some one or another of the other houses would have no effect upon the company's aggregate buying power. There is nothing in this record to support such a violent assumption or conjecture. The effect of the elimination or addition of amounts equal to the purchases made for the account of the San Francisco house was the subject matter of paragraph 9 of the Stipulation of Facts. (Jurisdictional Statement, pp. 14-15.) There was no equivalent stipulation as to the effect of the elimination or addition of amounts equal to the purchases made for the account of any of Appellant's other houses. Whatever such effect might be is not the proper subject matter of conjecture in deciding this case.

As to the second statement above quoted, there is nothing whatsoever in the stipulation as to what constitutes the so-called "central advertising division" mentioned in paragraph 4 of the stipulation and the expense of which constituted a part of the common expense. (Jurisdictional Statement, p. 13.) In Appellant's Petition for Rehearing in the court below, to which we have referred, Appellant offered to show by evidence that the

"so-called advertising of the company consists wholly

> in the preparation of catalogs and their distribution to retailers with whom the company does, or seeks to do, business, and that no advertising advantages other than certain economies of preparation exist by reason of the presence of the seven houses."

Likewise there is no such term used any where in the stipulation as "central accounting and management division"—although we can only assume that the court has in mind the statement in paragraph 4 of the stipulation that there are included in the allocated common expenses "executive salaries" and "certain accounting expenses." The court's statement, therefore, as to the economies of what it terms the "costly services of accounting and management" are wholly speculative and conjectural.

As to the last statement above quoted, we have already taken occasion to say that the court below, as does Appellee, seems in this indirect fashion to challenge the correctness of the *stipulated* facts as to the California loss. As has just been stated, the reason for there being a loss in California is of no relevancy as against the controlling factor that a loss did in fact result as shown by the stipulation. In Appellant's petition for rehearing in the court below Appellant as to this point offered to produce evidence as to why the San Francisco house operated at a loss. This portion of the petition for rehearing appears in the record. We point out, however, both as to this point and as to the nature of the so-called "central advertising division" Appellant has the right to produce the evidence itself—if such evidence is to be deemed material—and should not be required to present it to the court in any such summary manner.

Appellee now says that the ultimate conclusion from the facts stipulated as to the results of the Appellant's operations in California would itself be barred if our objection were good, and that therefore Appellant has stipulated itself out of court. The answer to this argument would

seem rather obvious. In the first place, Appellee is incorrect in saying that in such a case the California court would be guilty of a mere error which would not give this Court jurisdiction. When a reviewing court decides a case by indulging in inferences and presumptions and in speculation and conjecture contrary to the agreement and stipulation of the parties upon which the case was tried, which in terms precludes any decision from being made based upon any such inferences and presumptions or speculations or conjectures (Stipulation of Facts, par. 12) and resolves all of such inferences, presumptions, speculations and conjectures adversely to Appellant instead of remanding the case for the taking of further evidence to supply the deficiencies as said paragraph 12 of the Stipulation of Facts contemplated, appellant has in effect been denied an opportunity to be heard upon matters which, at least to the mind of the California court, were material facts. Such a situation is clearly within the principles announced in *Saunders* v. *Shaw*, 244 U. S. 317. Appellant certainly had no reason to anticipate that the California Supreme Court would find it necessary to, and would actually depart, from the stipulation of the parties in deciding this case adversely to appellant—certainly when the California Appellate Court in its opinion and judgment had held the assessment void. Jurisdictional Statement, Exhibit D, pp. 33-41. And this action having been done by the California Supreme Court in its opinion in this case, Appellant's first opportunity of objecting to such procedure was through its petition for rehearing herein. Where there is such a denial of an opportunity to be heard Appellant's constitutional rights have been infringed and the objection can be taken for the first time on the petition for rehearing. *Saunders* v. *Shaw, supra; Ex rel. Missouri Insurance Co.* v. *Gehner*, 281 U. S. 313; *Brinkerhoff-Faris Co.* v. *Hill*, 281 U. S. 673. See also *American Surety Co.* v. *Baldwin*, 287 U. S. 156; *Great Northern Ry. Co.* v. *Sunburst Oil & Refining Co.*, 287 U. S. 358.

The further answer is that Appellant's challenge was not directed to the Court's making the ultimate factual conclusion from the facts which were stipulated, but it was directed to such inferences and presumptions as the court indulged in when it questioned the stipulated facts and questioned whether or not a loss ever occurred and speculated as to the advertising division, and executive salaries and accounting expenses. Finally we point out that even if Appellee were correct and the court below was precluded from making the ultimate conclusion from the stipulated facts that a loss resulted in California, paragraph 12 of the Stipulation would still operate and the case would have to be returned to the trial court for the taking of further proofs as the Stipulation in terms provides.

Appellee, on page 9 of its Motion and Argument, states that the purpose of the Stipulation

> "was to overcome the presumption of official regularity and not to shift the burden of proof from plaintiff to defendant or to remove the burden of proof from both parties."

Nothing in the Stipulation suggests that paragraph 12 had any such limited or restricted meaning or effect. The obvious purpose of a stipulation of facts is to obviate the time and expense of taking evidence as to factual matters which are agreed upon by the parties. It was supposed by both parties that the facts stipulated were sufficient to permit of a decision of this case upon the merits. The purpose of the stipulation was to preclude any decision adverse to either Appellant or Appellee in the possible event that the facts as stipulated were insufficient to permit of a decision being made. This can only be the meaning of paragraph 12 in providing that if

> "this stipulation fails to establish any fact necessary to a decision, the case shall be reopened for the taking of further proofs with respect thereof." (Stipulation of Facts, paragraph 12.)

We do not question the right of the court below to refuse to decide a question of such importance as that involved in the present case if the facts presented to it are not adequate in its view for the purpose. That was what the stipulation was intended to accomplish—and specifically to preserve the right of either party in such an event to offer evidence as to any matters which the Court might deem material and which were not covered by the stipulation. To send the case back for a further hearing pursuant to the agreement embodied in said paragraph 12 of the stipulation is a far cry from speculating upon matters not covered by the stipulation—at least in the Court's mind—and indulging in inferences and conclusions adverse to Appellant. Appellant contends that the stipulated facts are adequate without additions thereto by the Court in the way of inference or presumption to decide the Federal question presented, and that the facts as stipulated require a decision in Appellant's favor if the case is to be decided consistently with the principles announced in the *Rees* case. The decision of the California Supreme Court in these respects is what we are seeking to have this Court review on appeal and, as we believe, as a matter of right—and this wholly without regard to how this Court ultimately decides the question. Otherwise the State Court is made the final arbiter as to rights granted Appellant under the Federal Constitution.

And if in the face of paragraph 12 of the Stipulation the stipulated facts themselves are deemed insufficient to permit of a decision of this case, and if thereupon the case is to be decided adverse to Appellant contrary to such stipulation, Appellant certainly has been denied the requisite opportunity to be heard as to the validity of the tax in question.

We respectfully ask that Appellee's motion to dismiss or affirm be denied.

As we endeavored to point out in our Jurisdictional Statement at page 19, we do not understand that this Court regards the *Rees* case as overruled or shaken in any way by any of its later decisions. As we understand it, in the *North American Cement* case the State accepted the *Rees* case without question, and argued the case upon the ground that it came within the principles of the *Underwood* and *Bass* cases rather than the *Rees* case. If the *Rees* case is not to be adhered to the Court can so state in deciding the case of the present Appellant.

Respectfully submitted,

LELAND K. NEEVES,
JAMES S. MOORE, JR.,
Attorneys for Appellant.